(21)

No. 91-1135

Supreme Court, U.S.
FILED
JUN 5 1992
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

NEWARK MORNING LEDGER COMPANY,
as successor to the Herald Company,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

BRIEF OF THE AMERICAN BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

Of Counsel:
PHILIP C. COOK
TERENCE J. GREENE
TIMOTHY J. PEADEN

ALSTON & BIRD
1201 W. Peachtree Street
Atlanta, Georgia 30309
(404) 881-7000

JOHN J. GILL III
Counsel of Record
MICHAEL F. CROTTY
JOANNE AMES

AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 663-5026

Counsel for Amicus Curiae

June 5, 1992

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED

Whether the Third Circuit, in acknowledged conflict with other circuits and the United States Tax Court, was correct that under the Internal Revenue Code an income-producing wasting intangible asset may be nondepreciable "goodwill" as a matter of law.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iv
INTEREST OF THE AMICUS CURIAE	1
STATEMENT OF THE CASE	4
SUMMARY OF THE ARGUMENT	5
ARGUMENT	7
I. THE THIRD CIRCUIT HAS ERRONEOUSLY ADOPTED THE *PER SE* RULE REJECTED BY *HOUSTON CHRONICLE*	7
II. THIS CASE SHOULD NOT BE USED TO OVERTURN SETTLED LAW HOLDING THAT CORE DEPOSIT INTANGIBLE ASSETS WERE SEPARATE AND DISTINCT FROM GOODWILL	11
A. The Third Circuit Mischaracterized the Tax Court's Opinion in *Citizens and Southern*	11
B. The Core Deposit Intangible Is Separate and Distinct from Goodwill	13
1. *Banks will pay a premium to acquire core deposits and the level of core deposits affects the purchase price*	13
2. *Core deposits trade separately in the marketplace*	15
3. *Generally accepted accounting principles and regulatory accounting principles require core deposit intangibles to be recorded as separate from goodwill*	16
III. THE RULE OF *HOUSTON CHRONICLE* SHOULD NOT BE REPLACED BY *PER SE* RULES	18
A. The Case Law Does Not Support Any *Per Se* Rules	18

B. The Proposed *Per Se* Rule Is Unworkable	22
1. *The proposed rule will only promote uncertainty and further litigation*	22
2. *The proposed rule does not help the finder of fact determine what is a reasonable allowance for depreciation*	24
IV. ANY CHANGE IN THE LAW REGARDING THE AMORTIZATION OF INTANGIBLES SHOULD BE MADE BY CONGRESS	27
CONCLUSION	30

TABLE OF AUTHORITIES

CASES:

	Page
AmSouth Bancorporation v. United States, 681 F. Supp. 698 (N.D. Ala. 1988)	19,20
Banc One Corp. v. Commissioner, 84 T.C. 476 (1985), *aff'd mem.*, 815 F.2d 75 (6th Cir. 1987)	14
Boe v. Commissioner, 307 F.2d 339 (9th Cir. 1962)	5
Business Services Industries, Inc. v. Commissioner, 51 T.C.M. (CCH) 539 (1986)	9,22,24
Citizens and Southern Corp. v. Commissioner, 91 T.C. 463 (1988), *aff'd per curiam*, 900 F.2d 266 (11th Cir. 1990)	*passim*
Colorado National Bankshares v. Commissioner, 60 T.C.M. (CCH) 771 (1990), *appeal docketed*, No. 91-9019 (10th Cir. Sept. 27, 1991)	*passim*
Colorado Springs National Bank v. United States, 505 F.2d 1185 (10th Cir. 1974)	18
Commissioner v. Idaho Power Co., 418 U.S. 1 (1974)	18
Commissioner v. Killian, 314 F.2d 852 (5th Cir. 1963)	5
Dalton v. Commissioner, 21 T.C.M. (CCH) 435 (1962)	14
Decker v. Commissioner, 864 F.2d 51 (7th Cir. 1988)	10
Dickman v. Commissioner, 465 U.S. 330 (1984)	14
Donrey, Inc. v. United States, 809 F.2d 534 (8th Cir. 1987)	19,20
First Pennsylvania Banking & Trust Co. v. Commissioner, 56 T.C. 677 (1971), *acq.* 1972-1 C.B. 2	22,24
General Television, Inc. v. United States, 449 F. Supp. 609 (D. Minn. 1977), *aff'd*, 598 F.2d 1148 (8th Cir. 1979) (per curiam)	19

Table of Authorities Continued

	Page
Hamm v. Commissioner, 325 F.2d 934 (8th Cir. 1963), *cert. denied*, 377 U.S. 993 (1964)	27
Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240 (5th Cir. 1973), *cert. denied*, 414 U.S. 1129 (1974)	*passim*
Illinois Cereal Mills, Inc. v. Commissioner, 46 T.C.M. (CCH) 1001 (1983), *aff'd*, 789 F.2d 1234 (7th Cir. 1986), *cert. denied*, 479 U.S. 995 (1986)	11
IT&S of Iowa, Inc. v. Commissioner, TAX CT. REP. (CCH) (97 T.C. 496) 4550 (Nov. 12, 1991)	3,12,15,18
Ithaca Industries, Inc. v. Commissioner, TAX CT. REP. (CCH) (97 T.C. 253) 4439 (Aug. 12, 1991)	9,14,24
KFOX, Inc. v. United States, 810 F.2d 1365 (Ct. Cl. 1975)	14,15,16
Laird v. United States, 556 F.2d 1224 (5th Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978)	*passim*
McCarthy v. United States, 807 F.2d 1306 (6th Cir. 1986)	10
Midlantic National Bank v. Commissioner, 46 T.C.M. (CCH) 1464 (1983)	10,14,15
NCNB Corp. v. United States, 684 F.2d 2185 (4th Cir. 1982) (*en banc*)	18
Newark Morning Ledger Co. v. United States, 945 F.2d 555 (3rd Cir. 1991)	8
Newark Morning Ledger Co. v. United States, 734 F. Supp. 176 (D.N.J. 1990)	*passim*
Northern Natural Gas Co. v. O'Malley, 277 F.2d 128 (8th Cir. 1960)	17
Panichi v. United States, 834 F.2d 300 (2d Cir. 1987) (per curiam)	10,21,24
Peoples Bancorporation v. Commissioner, TAX CT. MEM. DEC. (CCH) (63 T.C.M.) 3028 (May 18, 1992)	*passim*

Table of Authorities Continued

	Page
Ralph W. Fullerton Co. v. United States, 500 F.2d 548 (9th Cir. 1977)	10
Richard S. Miller & Sons, Inc. v. United States, 537 F.2d 446 (Ct. Cl. 1976)	10,13
Robins & Weill, Inc. v. United States, 382 F. Supp. 1207 (M.D.N.C. 1974)	21
Seaboard Finance Co. v. Commissioner, 23 T.C.M. (CCH) 1512 (1964), *aff'd*, 367 F.2d 646 (9th Cir. 1966)	22
Selig v. United States, 740 F.2d 572 (7th Cir. 1984)	25
Sisto Financial Corp. v. Commissioner, 149 F.2d 268 (2d Cir. 1945)	27
Southern Bancorporation, Inc. v. Commissioner, 732 F.2d 374 (4th Cir. 1984), *cert. denied*, 469 U.S. 1207 (1985)	10
Southern Bancorporation, Inc. v. Commissioner, 847 F.2d 131 (4th Cir. 1988)	10
Super Food Services, Inc. v. United States, 416 F.2d 1236 (7th Cir. 1969)	22
Thor Power Tool Co. v. Commissioner, 439 U.S. 522 (1979)	17
Trustmark Corp. v. Commissioner, No. 18372-89 (T.C. filed July 18, 1989)	15
Uecker v. Commissioner, 81 T.C. 983 (1983)	24
STATUTES:	
Internal Revenue Code of 1986, Section 167	4
Internal Revenue Code of 1986, Section 446	17
REGULATIONS:	
Treasury Regulation § 1.167(a)-3	18
Treasury Regulation § 1.446-1(a)	17
Treasury Regulation § 1.471-2(a)(2)	17

Table of Authorities Continued

	Page
MISCELLANEOUS:	
Accounting Principles Board Opinion No. 17, Intangible Assets (Aug. 1970)	16
Brief for the United States on a Petition for Writ of Certiorari	*passim*
Financial Accounting Standards Board Interpretation No. 9, Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method (Feb. 1976)	16
Financial Accounting Standards Board Statement No. 72, Accounting for Certain Acquisitions of Banking or Thrift Institutions (Feb. 1983)	16
H.R. 3035, 102nd Cong. 1st Sess. 127 CONG. REC. 5908 (1991)	28
Office of the Comptroller of the Currency, Accounting for Intangible Assets, Banking Circular 164-Revised (July 1985)	17
Office of the Comptroller of the Currency, Interim Policy with Respect to the Accounting Treatment for Purchased Core Deposit Intangible, Banking Circular No. 164 (Dec. 1981)	17
Priv. Ltr. Rul. 8311002 (Nov. 17, 1982)	13
Statement of Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy) Department of the Treasury, Before the Committee on Finance, United States Senate (April 28, 1992)	7
Statement of Kenneth W. Gideon, Assistant Secretary (Tax Policy), Department of Treasury, Before the Committee on Ways and Means, United States House of Representatives (Oct. 2, 1991)	28
Tax Fairness and Economic Growth Acceleration Act of 1992, H.R. 4210, § 4501 (Mar. 20, 1992)	28

Table of Authorities Continued

	Page
Tax Fairness and Economic Growth Acceleration Act of 1991-Veto Message from the President of the United States, 138 CONG. REC. H1604 (Mar. 24, 1992)	29
Testimony of Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy) Department of the Treasury, Before the Committee on Finance, United States Senate (April 28, 1992)	7,23,28,29
The Securities and Exchange Commissioner's Staff Accounting Bulletin No. 42, Application of Existing Accounting Standards to Business combinations Accounted for by the Purchase Method Involving Financial Institutions (Dec. 23, 1981)	17
Title X, Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330 (1987)	27

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-1135

NEWARK MORNING LEDGER CO.,
as successor to The Herald Company,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

BRIEF OF THE AMERICAN BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF THE AMICUS CURIAE

The American Bankers Association ("ABA") hereby respectfully submits this brief as amicus curiae in support of the Petitioner and with the consent of both of the parties. The signed consents of each are filed with this brief.

The ABA is the principal national trade association of the commercial banking industry in the United States. It has members located in each of the fifty states and the District of Columbia and includes banks of all types and sizes—money center, regional, and community banks. ABA members hold approximately ninety percent of the domestic assets of United States banks. The ABA is in a unique position to express the views of financial institutions regarding the issues raised in this case, especially the Solicitor General's invitation to overrule *Citizens and Southern Corp. v. Commissioner*, 91 T.C. 463 (1988), *aff'd*

per curiam, 900 F.2d 266 (11th Cir. 1990), and other cases holding that core deposit intangible assets were separate and distinct from goodwill.

Checking, savings, and other deposits, referred to collectively in the banking industry as core deposits, are banks' lowest cost source of funds. Although core deposits are a stable source of funds, they do not remain with a bank indefinitely but close at predictable rates as depositors marry, die, move, or close their accounts for other reasons.

The level of core deposits is an important factor in determining the purchase price of a bank. All other factors being equal, a purchaser is willing to pay more for a bank that has a higher level of core deposits because those deposits can be used to fund loans and other investments at a lower cost than alternative sources of funds. Indeed, it is often the acquisition of the core deposits that represents the economic purpose behind the purchase of a bank.

The core deposit intangible asset, or deposit base, is the intangible asset recorded in a purchase transaction representing the value of the acquired core deposits. Because the core deposit intangible is a wasting asset with a determinable useful life, banks are required by generally accepted accounting principles, by the bank regulatory agencies (the OCC, the FDIC, and the Federal Reserve), and by the SEC, to record the core deposit intangible as an asset separate from goodwill and to amortize it over the expected useful life of the purchased core deposit accounts in order to reflect income clearly.

In *Citizens and Southern Corp. v. Commissioner*, 91 T.C. 463 (1988), *aff'd per curiam*, 900 F.2d 266 (11th Cir. 1990), the Tax Court, in a reviewed decision, held that the core deposit intangible was an amortizable intangible asset. Rejecting the government's contention that the core deposit intangible was goodwill as a matter of law, the Tax Court applied the rule of *Houston Chronicle Publishing Co. v. United States*, 481 F.2d 1240 (5th Cir. 1973), *cert. denied*, 414 U.S. 1129 (1974), that amortizability is a question of fact. The Tax Court found that the core deposit intangible had (1) an ascertainable cost basis separate and distinct from goodwill, and (2) a limited useful life which can be ascertained with reasonable accuracy.[1]

In *Newark Morning Ledger Co. v. United States*, 945 F.2d 555 (3rd Cir. 1991), the Third Circuit misread the Tax Court's opinion in *Citizens and Southern*. Contrary to statements in the Third Circuit's opinion, the Tax Court is not part of "a minority strand amid the phalanx of cases." 945 F.2d at 565. Instead, the Tax Court explicitly follows the rule of *Houston Chronicle* that amortization is a question of fact. By choosing to abandon the rule of *Houston Chronicle* in favor of a new *per se* rule of law, it is the Third Circuit which has adopted a minority view in conflict with every other circuit which has considered the issue since *Houston Chronicle*.

Of greater concern, however, is the Solicitor General's request to abandon the rule of *Houston Chronicle* in favor of a proposed *per se* rule that would apply to all assets in all industries. Although pointedly having chosen not to ask this Court two years ago to review the fully developed factual record in *Citizens and Southern*, the Solicitor General now proclaims that *Citizens and Southern* is inconsistent with the suggested *per se* rule, and invites the Court to overrule it in this case, when none of those facts are before the Court. Brief for the United States on a Petition for a Writ of Certiorari at 13-15.

The ABA believes that its views will be of assistance to the Court in deciding whether the rule of *Houston*

---

[1] After *Citizens and Southern*, a memorandum decision was entered in *Colorado National Bankshares, Inc. v. Commissioner*, 60 T.C.M. (CCH) 771 (1990), *appeal docketed*, No. 91-9019 (10th Cir. Sept. 27, 1991). Following the Third Circuit's opinion below, the Tax Court in *IT&S of Iowa, Inc. v. Commissioner*, TAX CT. REP. (CCH) (97 T.C. 496) 4550 (Nov. 12, 1991), and *Peoples Bancorporation v. Commissioner*, TAX CT. MEM. DEC. (CCH) (63 T.C.M.) 3028 (May 18, 1992), reaffirmed the rule of *Houston Chronicle* and the amortization of core deposit intangibles.

Chronicle should be abandoned in favor of any new *per se* rule. Numerous bank acquisitions, past and present, have been consummated in reliance on existing law, in which the *Houston Chronicle* standard and its application in *Citizens and Southern* govern the amortization of intangible assets. Changing to a new *per se* rule that would deny the amortization of the core deposit intangible, an asset recognized by the banking industry, the accounting profession, the bank regulatory agencies, the Securities and Exchange Commission, and the courts to be separate and distinct from goodwill, would have a profound effect on the banking industry.

STATEMENT OF THE CASE

This case specifically concerns whether a depreciation deduction may be taken by Newark Morning Ledger Company under section 167 of the Internal Revenue Code for the portion of the purchase price of eight Michigan newspapers allocable to a "paid subscribers" intangible asset. The district court found, as a fact, that the asset had a limited useful life and, based upon the stipulation of parties, that the life could be determined with reasonable accuracy. *Newark Morning Ledger Co. v. United States*, 734 F. Supp. 176, 180-81 (D.N.J. 1990), *rev'd*, 945 F.2d 555 (3rd Cir. 1991). The district court further found, as a fact, that the asset had an ascertainable value that was separate from goodwill. 734 F. Supp. at 181-83.

Acknowledging the government's concession that the asset had an ascertainable value and limited useful life, the Third Circuit framed the issue as whether those factual findings were sufficient to satisfy the rule of *Houston Chronicle*. 945 F.2d at 559-60. The government argued that those factual findings do not mean the asset is "separate and distinct" from goodwill as the term "has been repeatedly characterized in the case law." *Id.* at 559. The taxpayer, on the other hand, argued that "properly defined, goodwill is no more than the residual value that remains after all assets with determinable useful lives and ascertainable values have been accounted for." *Id.* at 560.

After noting that there is not a "uniform or coherent definition" of the term goodwill, 945 F.2d at 559 n.5, the Third Circuit then divined two competing definitions in the case law. *Id.* at 559-567. The court contrasted descriptions of goodwill in the case law as "the expectancy that old customers will resort to the old place" and "the expectancy of continued patronage, for whatever reason" (quoting *Commissioner v. Killian*, 314 F.2d 852, 855 (5th Cir. 1963) and *Boe v. Commissioner*, 307 F.2d 339, 343 (9th Cir. 1962)), with a "residual" definition, purportedly applied by the Tax Court. The Third Circuit believed that the Tax Court's decisions in *Citizens and Southern* and *Colorado National Bankshares* "represent no more than a minority strand amid the phalanx of cases that have considered the definition and application of the term 'goodwill.' " *Id.* at 565. Believing instead that descriptions of goodwill as the expectancy of continued patronage are "consistent with the prevailing case law," *id.* at 568, the Third Circuit concluded that "the district court had applied the wrong definition of 'goodwill.' " *Id.*

Instead of remanding the case to the district court for further factual findings in accordance with *Houston Chronicle*, the Third Circuit agreed with the Commissioner that "there are *some* intangible assets which, notwithstanding that they have wasting lives that can be estimated with reasonable accuracy and ascertainable values, are nonetheless goodwill and nondepreciable." *Id.* (emphasis added). In an apparent attempt to define what intangible assets comprise the "some," the Third Circuit adopted a rule of law that "[c]ustomer lists are *generally* not depreciable when acquired in conjunction with . . . a going concern." *Id.* (emphasis added).

SUMMARY OF THE ARGUMENT

Ever since the landmark decision in *Houston Chronicle*, it has been clear that there are no *per se* rules prohibiting depreciation of intangible assets. The Third Circuit, however, adopted a new *per se* rule that is utterly inconsistent with the entire modern case law of depreciation. While

purporting to rely on *Houston Chronicle*, the Third Circuit in fact has resurrected the same *per se* rule of law advanced by the government and rejected by the Fifth Circuit in that case.

In fashioning its *per se* rule, the Third Circuit ignored or mischaracterized the case law, particularly *Citizens and Southern Corp. v. Commissioner*, 91 T.C. 463 (1988), *aff'd per curiam*, 900 F.2d 266 (11th Cir. 1990). *See infra* note 5 and accompanying text. In that case, the Tax Court applied the *Houston Chronicle* test, and found as a fact that the core deposit intangible was separate and distinct from goodwill as that term is interpreted in the case law. 91 T.C. at 480-500. The record in *Citizens and Southern* showed that the core deposit intangible was valued as a separate asset in determining the purchase price of a bank, trades separately in the marketplace, and was required to be treated as a separate asset for financial and regulatory accounting purposes in order to reflect income clearly. *Id.* at 495-500.

Neither the Third Circuit nor the Solicitor General offers any cogent reason why decades of established law should be jettisoned in favor of a new rule which makes illogical and artificial distinctions among different wasting assets. There is no reason for the Court to accept this invitation to depart from established law. Rather than put an end to current litigation,the suggested new rule would only promote further litigation as the government and taxpayers wrestle about its applicability, scope, and significance for other assets in diverse factual settings, all without the benefit of existing case law. Moreover, the Court does not have before it the record to fashion a *per se* rule to apply to all assets in all industries.

This Court is effectively being asked to adopt what amounts to a legislative solution to what the Solicitor General describes as "a substantial volume of litigation in the past and present." Brief for the United States on Petition for a Writ of Certiorari at 15. Congress is currently considering legislation that would resolve disputes over the

depreciation of intangible property, just as Congress acted in the past to resolve disputes over the depreciation of tangible property, by providing a uniform period for the amortization of all intangible assets. This legislation was recently described by the Treasury Department as "the centerpiece of our simplification efforts." Statement of Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy) Department of the Treasury, Before the Committee on Finance, United States Senate (April 28, 1992).

Absent any legislative change to the Internal Revenue Code, the determination of a "reasonable allowance for depreciation" is and should remain a question of fact.

ARGUMENT

I. THE THIRD CIRCUIT HAS ERRONEOUSLY ADOPTED THE *PER SE* RULE REJECTED BY *HOUSTON CHRONICLE*.

In *Houston Chronicle*, the taxpayer sought to amortize the value of newspaper subscription lists. Relying on the "mass asset rule," the Commissioner argued that the subscription lists were similar to goodwill and thus nondepreciable. The government's brief stated its position as follows:

> Since the nature of goodwill is the expectancy that old customers will resort to the old places and the expectancy of continued patronage . . . the term goodwill, for tax purposes, encompasses a wide spectrum of intangibles which are associated with favorable customer patronage. . . . Thus, goodwill is the sum total of all the imponderable qualities which attract customers and bring patronage to the business.

Houston Chronicle, 481 F.2d at 1248 n.5. The court, however, rejected "the establishment of a *per se* rule . . . that would amalgamate all subscriptions lists with goodwill." *Id.* at 1253.

In *Newark Morning Ledger*, however, the government argued, and the Third Circuit agreed, that there is a *per*

se rule that "[c]ustomer lists are generally not depreciable when acquired in conjunction with the sale of an underlying business as a going concern." 945 F.2d at 568. Indeed, the government argues, and the Third Circuit seems to agree, that the *per se* rule should apply to any terminable-at-will contract or noncontractual relationship acquired in conjunction with the purchase of an ongoing business if the value is in any way contingent upon continued customer patronage. Brief for the United States on Petition for Writ of Certiorari at 9, 15; *Newark Morning Ledger*, 945 F.2d at 560, 569. It is unfathomable, however, how the government or the Third Circuit can maintain that any *per se* rule is not only consistent with, but in fact supported by, the holding in *Houston Chronicle* that there are no *per se* rules.

In embracing the government's *per se* rule that customer lists acquired in connection with an ongoing business are generally not depreciable, the Third Circuit ignores the factual situation present in *Houston Chronicle*. The Third Circuit asserts that: "In the context of the sale of a going concern, it is simply often too difficult for the taxpayer and the court to separate the value of the list *qua* list from the goodwill value of the customer relationships." *Id.* at 568. In contrast, "the Service argues that, unlike the present dispute, *there was no goodwill transferred in the acquisition of the assets of Houston Chronicle* and thus no risk that goodwill would be bound up and depreciated along with the subscriber list." *Id.* at 562 (emphasis added). Moreover, in *Houston Chronicle* the taxpayer "did not purchase an ongoing business . . . but rather the idle assets of the defunct *Houston Press*." *Id.*

What the government misstated, and the Third Circuit overlooked, is that goodwill was transferred in the acquisition in *Houston Chronicle*, along with virtually all of the operating assets of an ongoing business. Despite the government's contention below that there was no goodwill transferred in *Houston Chronicle*, 945 F.2d at 562, the Fifth Circuit's opinion clearly recites that the jury allocated $775,400 (or 17 percent of the purchase price) to

goodwill. 481 F.2d at 1244. Furthermore, the purchaser, the *Houston Chronicle*, acquired the land, improvements, fixtures, inventory, equipment, library, and subscription lists owned by the seller, the *Houston Press*. *Id.* at 1243. In addition, the purchaser obtained a ten-year covenant not to compete from both the *Houston Press* and its parent newspaper chain, the E.W. Scripps Company. *Id.*[2] The only asset apparently not transferred was the right to use the Scripps-Howard "light-house design." *Id.* at 1243 n.2. The *Houston Press* did not stop publication until March 20, 1964, the day the purchase agreement was announced to the general public. *Id.* at 1244.

Moreover, the government's professed belief that *Houston Chronicle* supports its proposed *per se* rule conflicts with its inconsistent positions in subsequent litigation. Just a few years after *Houston Chronicle*, the government argued unsuccessfully in *Laird v. United States*, 556 F.2d 1224 (5th Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978), that *fixed-term* contracts were goodwill as a matter of law. Although rebuffed by the Fifth Circuit once again in *Laird*, the government has continued to argue that fixed-term contracts are nonamortizable simply because the value may be contingent on "expected customer patronage." *See, e.g.*, *Ithaca Industries, Inc. v. Commissioner*, TAX CT. REP. (CCH) (97 T.C. 253) 4439 (Aug. 12, 1991) (government argued unsuccessfully that favorable yarn supply contracts were inseparable from goodwill and going concern value); *Business Services Industries, Inc. v. Commissioner*, 51 T.C.M. (CCH) 539 (1986) (government argued unsuccessfully that Muzak customer contracts were inseparable from goodwill).[3] The government has also continued to argue

---

[2] The fact that the purchaser required a ten-year covenant not to compete from the seller, which was valued by the jury at $1,809,400 (or approximately 40 percent of the $4.5 million purchase price), 481 F.2d at 1244, plainly contradicts the government's characterization of the seller as "defunct."

[3] The Third Circuit wrongly believed that "the Service does not dispute, that value of the paid subscribers would not constitute goodwill

that customer lists are inextricably linked with goodwill as a matter of law even if they are *not* acquired in connection with an ongoing business. *See, e.g., Panichi v. United States*, 834 F.2d 300 (2d Cir. 1987) (per curiam); *Midlantic National Bank v. Commissioner*, 46 T.C.M. (CCH) 1464 (1983).

The government's actual position, although it is understandably reluctant to admit it, is that *Houston Chronicle* was wrongly decided and that all "customer or market-based intangibles" should be nonamortizable. Distinctions based on stated contract terms, or based on acquisition as part of an ongoing business, have been made by the government on a case-by-case basis, solely dependent upon the facts of the particular case it is then litigating. To date, the government has been singularly unsuccessful. Until the decision of the Third Circuit below, no circuit court had agreed with the government's argument that *Houston Chronicle* supported any *per se* rule. *Citizens and Southern Corp. v. Commissioner*, 900 F.2d 266 (11th Cir. 1990), *aff'g per curiam*, 91 T.C. 463, 479 (1988); *Decker v. Commissioner*, 864 F.2d 51, 54 (7th Cir. 1988); *Southern Bancorporation, Inc. v. Commissioner*. 847 F.2d 131, 136-37 (4th Cir. 1988); *Panichi v. United States*, 834 F.2d 300, 301 (2d Cir. 1987); *McCarthy v. United States*, 807 F.2d 1306, 1310 (6th Cir. 1986); *Ralph W. Fullerton Co. v. United States*, 550 F.2d 548, 550 (9th Cir. 1977); *Richard S. Miller & Sons, Inc. v. United States*, 537 F.2d 446, 452 (Ct. Cl. 1976).[4]

---

if Morning Ledger's 'expectation of continued patronage' were contractually-based." *Newark Morning Ledger*, 945 F.2d at 560.

[4] Indeed, prior to this case, there had been only one case involving the amortization of intangible assets, decided in the 20 years since *Houston Chronicle*, in which a circuit court reversed the trial court. In that case, *Southern Bancorporation, Inc. v. United States*, 732 F.2d 374 (4th Cir. 1984), *cert. denied*, 469 U.S. 1207 (1985), the district court's decision was not reversed on the basis of any *per se* rule of nonamortizability, but on the fact-specific ground that the acquirors' attempt to increase the basis of the loan portfolios was "wholly *post-hoc*."

II. THIS CASE SHOULD NOT BE USED TO OVERTURN SETTLED LAW HOLDING THAT CORE DEPOSIT INTANGIBLE ASSETS WERE SEPARATE AND DISTINCT FROM GOODWILL.

The concern of the American Bankers Association, as amicus curiae, is that the Solicitor General is improperly asking the Court to use this case as a vehicle to overturn *Citizens and Southern* and other cases holding, as a matter of fact, that core deposit intangible assets were separate and distinct from goodwill. Those cases, however, are not before the Court. The government chose not to seek this Court's review of the Eleventh Circuit's affirmance of an exhaustive 51-page opinion which carefully considered all of the government's *per se* arguments but instead based its decision, in accordance with *Houston Chronicle*, on a factual record consisting of the testimony of 15 witnesses and hundreds of documents. This Court should decline the Solicitor General's invitation to overrule a fact-based decision of the Tax Court involving a different intangible asset in a different industry. This case should not be used to question or usurp the factual determination in other cases that the core deposit intangible asset is an asset that is separate and distinct from goodwill.

A. The Third Circuit Mischaracterized the Tax Court's Opinion in *Citizens and Southern*.

Although claiming that the Tax Court applied the "wrong" definition of goodwill, the Third Circuit declined to distinguish *Colorado National Bankshares* and *Citizens and Southern*, stating that "such an exercise ultimately would prove pointless and . . . disingenuous." *Newark Morning Ledger*, 945 F.2d at 565.[5] The fundamental flaw

---

[5] The Third Circuit's original opinion, issued on September 12, 1991, did not even mention *Citizens and Southern*, which was decided by the Tax Court three years earlier, on September 6, 1988, 91 T.C. at 463, and affirmed by the Eleventh Circuit on March 22, 1990. 900 F.2d at 266. On October 15, 1991, the Third Circuit issued a revised opinion to include references to *Citizens and Southern*, 945 F.2d at 564 n.7a, 565, and 567, and to delete the statement in its original opinion that

in the Third Circuit's analysis is the erroneous assumption that the Tax Court has adopted or applied a different definition of goodwill.

Even a cursory review of *Citizens and Southern* makes it plain that the Tax Court has *not*, contrary to the statements in the Third Circuit opinion, collapsed the *Houston Chronicle* standard into a test whereby the showing of limited useful life satisfies the "separate and distinct" requirement. In fact, the Tax Court specifically rejected that position because it:

> fails to consider the case law interpreting goodwill within the meaning of the regulation. As a threshold matter, petitioner must establish that deposit base is an asset separate and distinct from goodwill as that term is interpreted in the case law.

Citizens and Southern, 91 T.C. at 480.[6] Accordingly, the Tax Court's opinion in *Citizens and Southern* spends twenty pages reviewing the record before holding that the "deposit base has an ascertainable cost basis separate and distinct from the goodwill and going-concern value." 91 T.C. at 480-500.[7] Only after satisfying this threshold question did the Tax Court turn to the separate issues of limited useful life and ascertainable value. *Id.* at 500-05, 505-10.[8]

"the Service submits that little weight should be accorded to the Tax Court's opinion in *Colorado National* since it is only a memorandum decision, the Service has not yet exhausted its appeals, and the Tax Court relied heavily upon the reasoning of the district court in the instant case in reaching its result."

[6] In each of its subsequent opinions involving the core deposit intangible, the Tax Court has similarly addressed the threshold issue of "separate and distinct from goodwill" before turning to the issues of limited useful life and ascertainable value. *IT&S of Iowa*, TAX CT. REP. (CCH) at 4556-57; *Colorado National Bankshares*, 60 T.C.M. (CCH) at 787-89; *Peoples Bancorporation*, TAX CT. MEM. DEC. (CCH) (63 T.C.M.) at 3092-12 to -15.

[7] The factors considered by the Court included: (1) the acquisition of core deposits was an important reason for the purchase of the bank and one of the key factors that determined the purchase price; (2) deposit base is recognized as separate from goodwill for financial and regulatory accounting purposes; (3) there are different techniques for valuing deposit base, including the income method and the cost savings method; and (4) separate transfers of core deposits do occur in the marketplace. 91 T.C. at 495-500.

In short, the Third Circuit's opinion is simply wrong when it characterizes the decisions of the Tax Court as a minority strand in the case law. Instead, applying the *Houston Chronicle* standard, the Tax Court properly considered all of the evidence before making a factual determination that the core deposit intangible asset was separate and distinct from goodwill as that term has been interpreted in the case law.

B. The Core Deposit Intangible Asset Is Separate and Distinct from Goodwill.

1. Banks will pay a premium to acquire core deposits and the level of core deposits affects the purchase price.

Fundamentally, a core deposit intangible asset is separate from goodwill because it is recognized and treated as a separate asset in the banking industry. The business of banking consists of borrowing money from depositors and investing in loans to customers or making other investments. The value of core deposits arises from the use of the low-cost funds to make those income-producing loans and other investments. A bank which obtains a low-cost source of funds for a predictable period of time through

[8] Courts have recognized limited useful life as a factor in determining that an asset is separate and distinct from goodwill. *See, e.g., Illinois Cereal Mills, Inc. v. Commissioner*, 46 T.C.M. (CCH) 1001, 1023-24 (1983), *aff'd*, 789 F.2d 1234 (7th Cir. 1986), *cert. denied*, 479 U.S. 995 (1986) (cited with approval by the Third Circuit, 945 F.2d at 566); *Richard S. Miller & Sons, Inc. v. United States*, 537 F.2d 446, 452 (Ct. Cl. 1976) ("most important indication"). On occasion, the Commissioner has agreed: "Section 1.167(a)-3 of the regulations gives us the *single factor* that determines whether an intangible asset is amortizable, which is that it must have a limited useful life that can be estimated with reasonable accuracy." Priv. Ltr. Rul. 8311002 (Nov. 17, 1982) (emphasis added).

the purchase of a group of core deposits has a commercial advantage, in the form of income deriving from lower operating costs, just like a business which obtains the right to use its premises at a rent that is lower than current market rents, or a business which obtains the right to purchase raw materials at a price that is lower than the current market price.[9]

Accordingly, in determining the purchase price of another bank, the purchaser will pay a premium for the core deposits, which represent a stable source of low-cost funds for a predictable period of time. *Citizens and Southern*, 91 T.C. at 498-99; *Midlantic National Bank v. Commissioner*, 46 T.C.M. (CCH) 1464, 1465-66 (1983); *Banc One Corp. v. Commissioner*, 84 T.C. 476, 490 (1985), *aff'd mem.*, 815 F.2d 75 (6th Cir. 1987). *See also Peoples Bancorporation*, TAX CT. MEM. DEC. (CCH) at 3029-15 (a seller of deposits considered their value when estimating potential bids for bank branches).[10]

In each of the core deposit cases, however, the government has attempted to redefine the core deposit intangible asset claimed by the taxpayer as something else in order to argue that it merely represents "continued patronage." The Tax Court has explicitly rejected this argument, stating:

---

[9] Bargain leases and favorable supply contracts are amortizable intangible assets. *See, e.g., KFOX, Inc. v. United States*, 510 F.2d 1365, 1378 (Ct. Cl. 1975); *Ithaca Industries*, TAX CT. REP. (CCH) at 4449; *Dalton v. Commissioner*, 21 T.C.M. (CCH) 435, 438-39 (1962). Although lease obligations, contract obligations, and core deposits themselves are liabilities, these decisions held that the benefit of below-market liabilities is an asset. *See also Dickman v. Commissioner*, 465 U.S. 330, 337 (1984) ("The right to the use of $100,000 without charge is a valuable interest in the money lent, as much so as the rent-free use of property consisting of land and buildings. In either case, there is a measurable economic value associated with the use of the property transferred. The value of the use of money is found in what it can produce.").

[10] In *Peoples Bancorporation*, the purchase agreement included a price adjustment if there was a material change in the level of deposits between the date the agreement was signed and the date of closing. TAX CT. MEM. DEC. at 3029-3.

> [P]etitioner is not attempting to depreciate the value of the [acquired] bank's customer structure or the expected value of continued patronage of the [acquired] bank's established clientele, 91 T.C. at 499; rather, it seeks to amortize only one separate component of the value petitioner acquired when it purchased the [acquired] bank, namely, the core deposits. While the [acquired] bank's customer structure may have had many more elements of value, which petitioner hoped to exploit, petitioner did not attempt to take those elements into account in calculating the amortization value of the deposit core. For instance, the prospect of selling as many banking services as possible to the customers of the acquired bank was a significant consideration in petitioner's decision to acquire the [acquired] bank, but the potential value of such opportunity did not figure in the calculations with respect to the deposit core.

IT&S of Iowa, TAX CT. REP. at 4556-57.

2. Core deposits trade separately in the marketplace.

Banks often buy the core deposits of failed banks separately from any other asset. *Citizens and Southern*, 91 T.C. at 498; *Peoples Bancorporation*, TAX CT. MEM. DEC. (CCH) at 3029-2 ("deposits are sometimes purchased separately from any other assets; the FDIC has done this in resolving insolvencies of troubled banks"); *see also Midlantic National Bank*, 46 T.C.M. (CCH) at 1475 (right to solicit deposits of a failed bank held to be an amortizable intangible asset). In recent litigation, even the Commissioner has admitted and stipulated that core deposits trade separately in the marketplace.[11] Although the tax law does

---

[11] In *Trustmark v. Commissioner*, Docket No. 18372-89 (T.C filed July 18, 1989), the government stipulated that:

> During the late 1980's and including the present time, banks have and can bid for and acquire the deposit liabilities of failed thrift institutions through the RTC. In such transactions, the

not require separate sales to establish that an intangible asset has determinable value separate from goodwill, *Citizens and Southern*, 91 T.C. at 492-93 (discussing *Laird v. United States*, 556 F.2d 1224 (5th Cir. 1977) and *KFOX, Inc. v. United States*, 510 F.2d 1365 (Ct. Cl. 1975)), there can be no clearer proof of separateness than the fact that bankers frequently can and do buy core deposits independently of any other asset.

3. Generally Accepted Accounting Principles and Regulatory Accounting Principles Require Core Deposit Intangibles To Be Recorded As Separate From Goodwill.

The core deposit intangible asset is not some abstract concept invented by banks for tax purposes, but a *mandatory* application of financial and regulatory accounting principles. Because the core deposit intangible has a definite useful life which can be estimated with reasonable accuracy, a bank's income will be overstated unless the amortization expense of the core deposit intangible is matched with the income derived from loans and other investments.

Under generally accepted accounting principles ("GAAP"), banks are *required* to record the core deposit intangible asset as a separate asset for financial reporting purposes and to amortize it over its useful life.[12] Because the book method clearly reflects income, Section 446 of

bank pays money to assume the deposit liabilities. In such circumstances, the bank may or may not purchase any other assets or properties of the thrift institutions.

[12] *See, e.g., Citizens and Southern*, 91 T.C. at 496-97 (discussing Accounting Principles Board Opinion No. 17, Intangible Assets (Aug. 1970); Financial Accounting Standards Board Interpretation No. 9, Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method (Feb. 1976); Financial Accounting Standards Board Statement No. 72, Accounting for Certain Acquisitions of Banking or Thrift Institutions (Feb. 1983)).

the Internal Revenue Code requires banks to amortize the core deposit intangible. I.R.C. § 446(a)-(b).[13] Although a GAAP method is not always controlling for tax purposes,[14] the amortization of core deposit intangibles is required because it clearly reflects income.[15]

The agencies which regulate banks and bank holding companies, including the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Securities and Exchange Commission, likewise require that the core deposit intangible asset be recorded as a separate asset and amortized over its useful life for regulatory accounting purposes.[16] Bank regulators *mandated* the treatment of the core de-

[13] Treas. Reg. § 1.446-1(a) provides:

> Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term "method of accounting" includes not only the over-all method of accounting of the taxpayer but also the accounting treatment of any *item*. . . . These methods of accounting for special items include the accounting treatment prescribed for . . . *depreciation*.

Id. (emphasis added).

[14] In *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), for example, the inventory method used by the taxpayer for book purposes failed to reflect income clearly as required by Treas. Reg. § 1.471-2(a)(2).

[15] As noted by the Fifth Circuit in *Houston Chronicle*: "The concurring opinion of then-Circuit Judge Blackmun makes clear, if the asset is shown to be a wasting one used in taxpayer's trade or business, a reasonable deduction must be allowed." 481 F.2d at 1251 (discussing *Northern Natural Gas Co. v. O'Malley*, 277 F.2d 128 (8th Cir. 1960)).

[16] *See, e.g., Citizens and Southern*, 91 T.C. at 497-98 & nn. 17-19 (discussing Office of the Comptroller of the Currency, Interim Policy with Respect to the Accounting Treatment for Purchased Core Deposit Intangible, Banking Circular No. 164 (Dec. 1981); Office of the Comptroller of the Currency, Accounting for Intangible Assets, Banking Circular 164-Revised (July 1985); The Securities and Exchange Commissioner's Staff Accounting Bulletin No. 42, Application of Existing Accounting Standards to Business Combinations Accounted for by the Purchase Method Involving Financial Institutions (Dec. 23, 1981)).

posit intangible asset as a separate asset because "its amortization was necessary in order to avoid distorting a bank's income." *IT&S of Iowa, Inc.*, TAX CT. REP. (CCH) at 4557 (discussing the testimony of Robert Storch of the FDIC).

Where, as in the case of core deposit intangible assets, "a taxpayer's generally accepted method of accounting is made compulsory by the regulatory agency *and* that method clearly reflects income, it is almost presumptively controlling of federal income tax consequences." *Commissioner v. Idaho Power Co.*, 418 U.S. 1, 15 (1974). Moreover, particular weight is given to the regulatory pronouncements of *bank* regulatory agencies because of their special expertise and close scrutiny of banks. *NCNB Corp. v. United States*, 684 F.2d 285, 293 (4th Cir. 1982) (*en banc*); *Colorado Springs National Bank v. United States*, 505 F.2d 1185, 1188 (10th Cir. 1974).

In summary, the records considered by the Tax Court in *Citizens and Southern*, *Colorado National Bankshares*, *IT&S of Iowa*, and *Peoples Bancorporation* proved as a factual matter that the core deposit intangible assets acquired by those taxpayers were separate and distinct from goodwill. The separate and distinct nature of the core deposit intangible asset is just one example demonstrating why there cannot be a blanket rule purporting to address different types of assets in different industries.

III. THE RULE OF *HOUSTON CHRONICLE* SHOULD NOT BE REPLACED BY *PER SE* RULES

A. The Case Law Does Not Support Any *Per Se* Rules.

The Third Circuit's opinion cites numerous decisions that purportedly "have considered the definition and application of the term 'goodwill' in the context of [Treas. Reg.] section 1.167(a)-3." *Newark Morning Ledger*, 945 F.2d 565-

66.[17] The Third Circuit found it necessary to review just a "few of these cases" in deciding to adopt its *per se* rule. *Id.* at 566. The Third Circuit's *per se* rule, however, is not supported by the few cases discussed in its opinion, nor by any of the other post-*Houston Chronicle* cases concerning the amortization of intangible assets.

The Third Circuit's opinion relies mainly on *General Television, Inc. v. United States*, 449 F. Supp. 609 (D. Minn. 1977), *aff'd*, 598 F.2d 1148 (8th Cir. 1979) (per curiam), and *AmSouth Bancorporation v. United States*, 681 F. Supp. 698 (N.D. Ala. 1988), the only post-*Houston Chronicle* cases cited by the Third Circuit which even intimate that there are any *per se* rules. The Third Circuit's interpretation of those two district court opinions, however, has been discredited by subsequent decisions in their respective circuit courts.

Although the Third Circuit's opinion mentions the Eighth Circuit's opinion in *Donrey, Inc. v. United States*, 809 F.2d 534 (8th Cir. 1987), it fails to note that the Eighth Circuit explicitly clarified that *General Television* does not stand for the proposition that terminable-at-will contracts acquired as part of an ongoing business are non-depreciable as a matter of law:

> The District Court in General Television simply applied the same test as used herein [the *Houston Chronicle* test] and reached a different conclusion based on different facts. *It does not entitle the government to judgment as a matter of law*, nor does it compel us to conclude that the instant subscription list is non-depreciable goodwill.

Donrey, 809 F.2d at 537 (emphasis added). The Third Circuit's opinion dismisses *Donrey* with the startling claim

---

[17] Curiously, although the Third Circuit concluded that the Tax Court uses the "wrong" definition of goodwill, many of the cases it cites are decisions of the Tax Court. The Third Circuit simply misunderstands that the Tax Court, like other courts, recognizes that whether an asset is separate and distinct from goodwill is a question of fact.

that *Donrey* is inconsistent with *Houston Chronicle*. 945 F.2d at 563. Far from being inconsistent with *Houston Chronicle*, *Donrey* is a straightforward application of the rule in *Houston Chronicle* that entitlement to depreciation depends upon the proof of the facts and circumstance concerning useful life and value. One of the facts determined by the trier of fact (in that case a jury) was that the asset acquired by the taxpayer was separate and distinct from goodwill.[18] Accordingly, applying the *Houston Chronicle* test, the taxpayer was entitled to depreciate the value of the acquired asset over its useful life. *Accord Panichi v. United States*, 834 F.2d 300 (2d Cir. 1987) (per curiam).

The Third Circuit's opinion also relies on the district court's opinion in *AmSouth Bancorporation v. United States*, even while conceding its "doubtful validity" after the Eleventh Circuit's affirmance of *Citizens and Southern*. 945 F.2d at 567. The Third Circuit's opinion erroneously attributes the difference in outcomes to *AmSouth*'s "opting for the traditional definition of goodwill." *Id.* at 567. The Tax Court applied the same definition of goodwill in *Citizens and Southern* that the district court applied in *AmSouth*. The Tax Court found, however, that the record in *Citizen and Southern* was different from the record in *AmSouth* and thus compelled a different result. 91 T.C. at 481. The *AmSouth* court recognized that the case law in this area did not establish *per se* rules, but "only serve to emphasize the factual nature of the issue." 681 F. Supp. at 718.[19]

---

[18] The Third Circuit apparently believed that *Donrey* may be explained by "the substantial deference due the jury's determination that the taxpayer had proved a value separate and distinct from goodwill." 945 F.2d at 563. The Third Circuit did not explain why it would not defer to a specific finding of fact by the Tax Court in *Citizens and Southern* that the core deposit intangible asset is separate and distinct from goodwill.

[19] The *AmSouth* court was careful to rest its *holding* on the taxpayer's failure of proof. The district court's *dicta* approving a *per se* rule are irreconcilable with the Eleventh Circuit's decision in *Citizens and Southern* and, as a former part of the Fifth Circuit, the controlling precedents

The Third Circuit, moreover, erroneously cites *Panichi v. United States*, 834 F.2d 300 (2d Cir. 1987) (per curiam), to support its view that *Houston Chronicle* is limited to those situations when the asset is not acquired as part of a going concern. Although *Panichi* noted that a customer list acquired separately from a going concern *may* be depreciated, it did not find that the same list acquired with a going concern can *never* be depreciable. *Id.* at 302. Moreover, the Second Circuit did not interpret *Houston Chronicle* as excluding terminable-at-will contracts whose value is based on customer patronage. In *Panichi*, the taxpayer was allowed to amortize a customer list valued on the basis of expected monthly receipts from the customers on the list. *Id.* at 301. While the facts do not state whether the contracts were terminable-at-will, that absence suggests that the Second Circuit (like all other circuits which have expressly considered the issue) would find the distinction irrelevant. In short, rather than supporting any *per se* rule, the Second Circuit recognized that "the depreciability of an intangible asset under this [*Houston Chronicle*] standard is largely a question of fact, dependent upon the circumstances in each case." *Id.*[20]

Unsupported even by the cases cited for authority, the Third Circuit's new *per se* rule is directly contrary to the

---

of *Houston Chronicle* and *Laird v. United States*, 556 F.2d 1224 (5th Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978).

[20] The Third Circuit has similarly misread the decision in *Robins & Weill, Inc. v. United States*, 382 F. Supp. 1207 (M.D.N.C. 1974). The district court did not interpret *Houston Chronicle* to establish a *per se* rule based on whether the asset was purchased as part of an ongoing business. Instead, the district court noted that "the depreciability of expiration lists is a factual question to be decided after the taxpayer has been given an opportunity to meet the dual test laid down in *Houston Chronicle*." 382 F. Supp. at 1213. The court then found the allocation of ten dollars to goodwill in the purchase agreement to be inadequate, and having no other basis on which to make an allocation, determined that the taxpayer had failed to prove its case. *Id.* at 1215. Nothing in the opinion supports the Third Circuit's *per se* rule that would deny a taxpayer the *opportunity* to carry its burden of proof under the *Houston Chronicle* test.

holdings of *Citizens and Southern*, 900 F.2d 266; *Donrey*, 809 F.2d 534; *Super Food Services, Inc. v. United States*, 416 F.2d 1236 (7th Cir. 1969);[21] and *First Pennsylvania Banking & Trust Co. v. Commissioner*, 56 T.C. 677 (1971), *acq.* 1972-1 C.B. 2.[22] These cases, among many others, *see supra* text accompanying note 4, all recognize that whether an intangible asset is separate from goodwill is a question of fact. In each of these cases, amortization was permitted for terminable-at-will contracts acquired as part of an ongoing business whose value is dependent upon continued customer patronage.

B. The Proposed *Per Se* Rule Is Unworkable.

1. The proposed rule will only promote uncertainty and further litigation.

A *per se* rule that "customer lists are *generally* not depreciable when acquired in conjunction with the sale of the underlying business as a going concern," will not resolve existing controversies but will instead promote additional uncertainty and further litigation.[23] Without a clear articulation of *all* the circumstances in which this "general" rule would and would not apply, neither taxpayers nor the government will be able to determine the applicability of the rule without further litigation.

The Solicitor General's attempt to frame a *per se* rule even more broadly, to deny amortization to all "customer and market-based intangibles" whose value is contingent on the "expected future patronage of its existing non-contractual customers," Brief for the United States on Petition for a Writ of Certiorari at 9, 15, would invite even more litigation. This rule is so amorphous that it defies definition.[24] The boundaries of dispute would merely shift as taxpayers and the government disagree about whether a particular situation involved "contractual relationships," whether the purchase was in "conjunction with an ongoing business," and whether the asset was linked to "expected future patronage from customers."

The American Bankers Association, as amicus curiae, is concerned that the government would attempt to rely on a *per se* rule to deny amortization to many intangible assets long recognized as separate and distinct from goodwill. For example, ever since the depreciability of mortgage servicing rights was established in a series of cases more than twenty years ago, not even the government has questioned the principle that mortgage servicing contracts

---

[21] In *Super Food*, as in *Citizens and Southern* and other cases, the fact that separate consideration was given to the asset in the purchase decision demonstrated that the asset was separate from goodwill. 416 F.2d at 1239 (separate value of the contracts considered in the purchase decision). *See, e.g., Business Services Industries, Inc. v. Commissioner*, 51 T.C.M. (CCH) 539, 543 (1986) ("The separate and distinct nature of the value of the location contracts is readily apparent from the fact that the bank was willing to finance the purchase of the stock by BSI with the contracts being used as the only collateral."); *Seaboard Finance Co. v. Commissioner*, 23 T.C.M. (CCH) 1512 (1964), *aff'd*, 367 F.2d 646 (9th Cir. 1966) (loan contracts individually valued).

[22] In *Citizens and Southern*, the government claimed that *First Pennsylvania* was distinguishable "because the taxpayer was assured the use of a fixed amount of funds over a fixed period of time pursuant to a formal written contract which it acquired." 91 T.C. at 489. That contention, however, "is simply not supported by the facts. The taxpayer was not assured the use of a fixed amount of funds for a fixed period of time. The lenders could terminate the service agreements by simply giving written notice." *Id.*

[23] "If the Supreme Court were to adopt the government's position that, as a matter of law, customer lists are intertwined with goodwill and cannot be amortized, I think you will still find that there are an unlimited number of controversies in this area." Testimony of Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy) Department of the Treasury, Before the Committee on Finance, United States Senate at 21 (April 28, 1992).

[24] The scope of the requested rule is hardly limited to a customer-based intangible, particularly in light of the Solicitor General's reference to the entire premium paid by a purchaser over the value of the *tangible* assets as "this premium associated with the going concern value or goodwill of the business." Brief for the United States on the Petition for Writ of Certiorari at 15.

are depreciable intangible assets.[25] Given the government's inconsistent litigating positions in *Laird*, *Panichi*, *Ithaca Industries*, and *Business Service Industries*, there is every reason to expect that the government will try to redefine any rule adopted by this Court in the same manner that it has attempted to redefine the rule of *Houston Chronicle*.

2. The proposed rule does not help the finder of fact determine what is a reasonable allowance for depreciation.

The Solicitor General's assumption that a *per se* rule would avoid recurring factual disputes is wrong. Rather, trial courts still would need to make the same sort of factual determinations currently required by *Houston Chronicle*.

For example, a *per se* rule making a distinction between fixed-term contracts and terminable-at-will contracts does not aid the finder of fact. Even if the contracts have fixed terms, the trial court must still determine whether the asset has a useful life which can be determined with reasonable accuracy. The Third Circuit wrongly believes that taxpayers depreciate "the value of those contracts over that time period." *Newark Morning Ledger*, 945 F.2d at 560. Instead, trial courts must first determine whether the contract will be renewed. If the contract will be renewed, the trial court must determine whether the useful life is indefinite or can be estimated with reasonable accuracy despite the renewals. *Compare Uecker v. Commissioner*, 81 T.C. 983, 993-998 (1983) (renewable fixed-term grazing privileges had an indefinite life), *with Business Services*, 51 T.C.M. (CCH) at 540, 543 (renewable five-year Muzak contracts held to have a 15-year useful life). Accordingly, despite the proposed rule, trial courts must still examine

[25] *See, e.g., First Pennsylvania*, a case in which the Commissioner acquiesced twenty years ago. Armed with a new *per se* rule, the Commissioner could once again try to argue that mortgage servicing rights acquired in connection with a going concern are nonamortizable because they are somehow linked to "future customer patronage."

fixed-term contracts on a case-by-case basis to determine useful life.[26]

Despite the proposed *per se* rule, trial courts will continue to be required to determine what assets are separate from goodwill. The *Houston Chronicle* standard has never meant that the asset in question must be an orphan, free from all relation to or contact with any element a court has ever described as part of the goodwill of a particular business.[27] Indeed, the value of many depreciable assets, including tangible assets, is dependent upon continued customer patronage.[28] Unless the rule is interpreted so broadly

[26] The need for the finder of fact to determine useful life, not simply the term of the contract, explains why courts have not made the distinction between terminable-at-will and fixed-term contracts. Neither the Third Circuit nor the government offers any reason why a distinction should be drawn between a terminable-at-will contract and a 30-day contract, both of which have a useful life of five years.

[27] As the Fifth Circuit stated in *Laird v. United States*, 556 F.2d 1224, 1234 (5th Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978): "That the assets contribute value to one another does not prevent their severability for tax purposes. . . . This is so even if the assets are worthless without one another." The Seventh Circuit has described *Laird* as having "settled" the question of the depreciability of intangible assets purchased in a bundle of interrelated assets. *Selig v. United States*, 740 F.2d 572, 575 n.9 (7th Cir. 1984).

[28] Concurring in *Citizens and Southern*, Judge Cohen put it best:

> I have found no authority for the proposition that assets, intangible or tangible, are not separate and distinct from goodwill unless no part of their value is related to continued patronage of customers of an ongoing business. As the majority opinion demonstrates in its exhaustive analysis of relevant authorities, assets are frequently found to be eligible for amortization even though the price paid took into account the probable continuance of terminable business relationships. . . . Tangible property, such as special purpose equipment, is unquestionably subject to depreciation even though its value may be enhanced by its use in an ongoing business. It seems to me that the requirement that an asset be separate and distinct means only that it must have a measurable value for a specific use.

91 T.C. at 515-16 (Cohen, J., concurring) (citations omitted).

as to deny amortization to all assets, tangible or intangible, which derive any part of their value from "future customer patronage," trial courts will not be aided in their determination by the *per se* rule proposed by the Solicitor General.

Finally, the proposed distinction between two identical assets based solely on whether the asset is acquired as part of an ongoing business does not simplify the factual determination. The government argued below and the Third Circuit agreed that the taxpayer in *Houston Chronicle* "did not purchase an ongoing business." Nonetheless, the finder of fact in *Houston Chronicle* still was required to allocate the purchase price among goodwill and the identifiable intangible assets including a customer list. Making the distinction proposed by the Third Circuit, therefore, does nothing to relieve the Third Circuit's concern that it is "often too difficult" for the court to determine a separate value for intangible assets. 945 F.2d at 568.

Perhaps no question is more peculiarly a question of fact than determining the fair market value of an asset. In its opinion, the Third Circuit intimates that its decision may have been different if the taxpayer had valued the asset using a different *appraisal technique*. Perhaps in that case, it seems, the "paid subscribers" intangible asset would have an ascertainable value separate and distinct from goodwill.[29] It is beyond dispute, however, that the trier of fact must be the one to determine valuation issues based on all of the evidence, including the experience in the industry, testimony of taxpayers and appraisers concerning market comparables, replacement cost, discounted cash flow, cost savings, or any other valuation issues brought before it.[30] If the trial court in fact applied the

[29] The suggestions by the Third Circuit that a different factual finding by the district court as to the value may have lead to a different result illustrates the fallacy inherent in the *per se* approach adopted by the court.

[30] It is the function of the trial court, not the appellate court, to judge the credibility of witnesses, to weigh the evidence, and to draw appropriate inferences. *Hamm v. Commissioner*, 325 F.2d 934, 938 (8th Cir. 1963), *cert. denied*, 377 U.S. 993 (1964). "An appellate court's powers of review are limited 'and that limitation is particularly narrow when the issue is one of value.'" 325 F. 2d at 938 (quoting *Sisto Financial Corp. v. Commissioner*, 149 F.2d 268 (2d Cir. 1945)).

wrong definition of goodwill, the proper remedy would be to remand, not to speculate about valuation issues on appeal, nor to adopt a *per se* rule that would prevent other taxpayers from having an opportunity to prove that other intangible assets do in fact have an ascertainable value separate from goodwill.

Until the decision below, trial courts have applied the rule of *Houston Chronicle* for twenty years and no circuit court has found it necessary to substitute any *per se* rules. The other circuit courts have recognized that depreciation can only be determined on a case-by-case basis because what constitutes "a reasonable allowance" will vary from one situation to another. Absent a change in the law to deny amortization for intangible assets, or to provide uniform amortization periods as was done previously for tangible assets, decades of settled law should not be abandoned to adopt the rule suggested by the Solicitor General.

IV. ANY CHANGE IN THE LAW REGARDING THE AMORTIZATION OF INTANGIBLES SHOULD BE MADE BY CONGRESS

Several years ago, Congress considered and rejected proposed legislation that would have enacted the rule the Solicitor General has proposed. Section 10120 of H.R. 3545, the Revenue Bill of 1987, proposed to deny amortization of subscription lists and other intangible assets. Although H.R. 3545 was enacted as Title X of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330, 1330-382 (1987), Congress did not enact the provision denying amortization of subscription lists and other intangible assets and has not enacted any of the more recent proposals to deny amortization of intangible assets.

Last year, Representative Dan Rostenkowski, Chairman of the House Ways and Means Committee, introduced pro-

posed legislation that would resolve the recurring factual disputes over the depreciation of intangible assets by statutory means. Rather than denying depreciation of certain intangibles by imposing any *per se* rule, H.R. 3035, 102nd Cong., 1st Sess., 137 CONG. REC. 5908 (1991), instead would eliminate the factual disputes necessitated by current law by permitting businesses to amortize all customer-based intangible assets, *including goodwill*, over a period of fourteen years.

The Rostenkowski bill was the subject of a congressional hearing on October 2, 1991, at which both the Treasury Department and American Bankers Association testified in support of the bill's enactment. In the Treasury Department's testimony, Assistant Secretary (Tax Policy) Kenneth W. Gideon indicated that:

> Commissioner Goldberg and I believe that H.R. 3035, which requires amortization of purchased goodwill and other intangible assets over 14 years, is one of the most important simplification proposals before you this year. If enacted, it would avoid innumerable tax controversies concerning the tax treatment of future acquisitions.

Statement of Kenneth W. Gideon, Assistant Secretary (Tax Policy), Department of the Treasury, Before the Committee on Ways and Means, United States House of Representatives at 1 (Oct. 2, 1991).

On March 20, 1992, Congress passed the "Tax Fairness and Economic Growth Acceleration Act of 1992," which included the 14-year amortization period for goodwill and other intangible assets. H.R. 4210, § 4501 (Mar. 20, 1992).[31]

[31] The final tax bill, H.R. 4210, was modified to include a retroactivity provision which would permit taxpayers to make an across-the-board election to amortize over a 17-year period. Treasury Department officials viewed this provision as unnecessary because they believed that current controversies could be settled on the same basis as the proposed legislation. Statement of Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy) Department of the Treasury, Before the Committee on Finance, United States Senate at 4-6 (April 28, 1992).

Although the Act was vetoed by President Bush, the veto was not triggered by the intangibles simplification provisions. *See* Tax Fairness and Economic Growth Acceleration Act of 1992-Veto Message from the President of the United States, 138 CONG. REC. H1604 (Mar. 24, 1992).

On April 28, 1992, current Assistant Secretary for Tax Policy, Fred T. Goldberg, Jr., testified before the Senate Finance Committee and reaffirmed the Treasury Department's support for a legislative solution. Mr. Goldberg testified:

> The legislation you are considering is the product of more than 18 months of cooperation among the Congress, the Administration, and the private sector. In many respects, it is the centerpiece of our simplification efforts. It is not perfect—but there is no such thing as the perfect law. It is fair and reasonable; it achieves its stated objectives and is consistent with fundamental principles of sound tax policy; and it is a dramatic improvement over the current state of affairs.

Statement of Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy) Department of the Treasury, Before the Committee on Finance, United States Senate at 2 (April 28, 1992).

The primary justifications offered by the Solicitor General in support of his *per se* rule are the "substantial volume of litigation past and present" and the "more than $4 billion of [proposed] adjustments in cases involving the depreciation of customer or market-based intangible assets." Brief for the United States on Petition for a Writ of Certiorari at 15-16. Those concerns are fully addressed by the current legislative efforts to simplify intangible asset depreciation. There is no reason for this Court to accept the Solicitor General's invitation to depart from established law.

CONCLUSION

The Third Circuit's decision in this case appears to hold that, as a matter of law, a customer list is generally not depreciable when acquired in conjunction with the sale of the underlying business as a going concern. That holding is contrary to existing law and should be reversed. If there was any error by the trial court in applying the *Houston Chronicle* standard, the Third Circuit should have remanded to the trial court for further findings of fact.

If the Court should decide *this* case in favor of the United States, however, the American Bankers Association respectfully submits that the Court is not required to expand its holding beyond the "paid subscribers" asset at issue in this case. There is no reason to adopt the broad *per se* rule advanced by the Solicitor General. Absent a legislative change to the Internal Revenue Code, depreciation is a question of fact, and the factual record in this case should not be used to decide the depreciability of any other asset. The record in this case should not be used to decide the depreciability of intangible assets acquired in other newspaper acquisitions, much less the depreciability of intangible assets in other industries, such as the core deposit intangible.

Respectfully submitted,

Of Counsel:
PHILIP C. COOK
TERENCE J. GREENE
TIMOTHY J. PEADEN

ALSTON & BIRD
1201 W. Peachtree Street
Atlanta, Georgia
(404) 881-7000

JOHN J. GILL III
Counsel of Record
MICHAEL F. CROTTY
JOANNE AMES

AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
Washington, D.C.
(202) 663-5026

Counsel for Amicus Curiae

June 5, 1992